

The over-indebtedness of European consumers under EU policy and law

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1. Introduction and background: EU Consumer over-indebtedness

For quite some time over-indebtedness has been perceived as a national problem to be addressed by the Member States. By the late 1980s there were already a number of national initiatives introducing personal bankruptcy or debt counselling services to seek solutions to household debt problems. They represented the response to the consequences of the rapid increase in the volume and variety of credit services in some Member States, especially in northern Europe. Such a variety and different openness of retail credit markets reflected a significant gap in the culture, tradition, use and pattern of consumer borrowing across the then EC. The diversity started to narrow only with the 1993 Maastricht Treaty and the establishment of the single market, alongside the liberalisation and opening-up of national credit markets for consumers.¹

Contextually, also EU policy-makers started to show an interest in consumer over-indebtedness as a side-effect of the common market. Reports commissioned by the European Commission and some literature have followed suits, recommending national actions and pointing towards the adoption of common principles for a European approach to the over-indebtedness of consumers. Such scholarship often directed towards debt restructuring or consumer insolvency regimes to capture common traits or trends towards possible convergence.²

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¹ E.g. see the early initiatives in Britain, France, Germany, Denmark, and The Netherlands. See Kilborn, “Two decades, three key questions, and evolving answers in European Consumer Insolvency Law: responsibility, discretion and sacrifice”, in Niemi, Ramsay, and Whitford (Eds.), *Consumer credit, debt and bankruptcy: comparative and international perspectives* (Hart 2009), 307-330; Huls, “Towards a European Approach to Overindebtedness of Consumers”, 16 *Journal of Consumer Policy* (1993), 215-234; Reifner, Kiesilainen, Huls, Springeneer, *Consumer Overindebtedness and Consumer Law in the European Union*, Final Report, Contract Ref. B5-1000/02/000353 (September 2003); Ramsay, “Between Neo-Liberalism and the Social Market: Approaches to Debt Adjustment and Consumer Insolvency in the EU”, 35 *Journal of Consumer Policy* (2012), 421-441.

² For all see Kilborn, *Expert recommendations and the evolution of European best practices for the treatment of overindebtedness, 1984-2010* (August 21, 2010), available at SSRN: <http://ssrn.com/abstract=1663108> or <http://dx.doi.org/10.2139/ssrn.1663108>.

According to internationally set principles, policy and legal interventions aiming at tackling over-indebtedness consist essentially of two main pillars:

- a) a first pillar with measures for the prevention of over-indebtedness; the legislative implementation of the broadly formulated principle of responsible lending is one of the main measures taken in this respect; and
- b) a second pillar with measures taken to address over-indebtedness *ex post*, i.e. the insolvency of the debtor/natural person and his reintegration in the economic and social life.³

However, in line with the efforts to achieve a single market in credit for consumers, the EU policy response to over-indebtedness has been in terms of preventively delivering a credit market that is ‘responsible’. The main objectives of EU measures to achieve the common market are directed towards the creation of a regime which encourages vigorous competition, innovation and choice within a trusty framework that rejects unfair and irresponsible practices. The focal drive is the economic one of enabling consumers and businesses to take full advantage of the single market.⁴

Even in the aftermath of the latest economic crisis the European Commission has stressed the importance for Member States of having “measures to *prevent* over-indebtedness and maintain access to financial services”⁵ (*emphasis added*). But the declared goal is to deliver “responsible and reliable financial markets for the future” announcing that “to ensure that European investors, consumers and SMEs can be confident about their savings, access to credit and their rights as concerns financial products, the Commission will come forward with (...) *measures on responsible lending and borrowing*”⁶ (*emphasis added*).

It appears evident how the creation of trust in the market is dominant and how to some extent the prevention of over-indebtedness has remained blurred in the quest for the promotion of

³The World Bank, *Responsible Lending - Overview of Regulatory Tools* (October 2013); Consumers International, *Responsible lending: An International Landscape* (November 2013); OECD, G-20, *High-Level Principles on Financial Consumer Protection* (October 2011); Financial Stability Board, *Principles for Sound Residential Mortgage Underwriting Practices*, (April 2012); G20/OECD Task Force on Financial Consumer Protection, *Effective Approaches to Support the Implementation of the Remaining G20/OECD High-Level Principles on Financial Consumer Protection* (September 2014); FinCoNet, *FinCoNet report on responsible lending – Review of supervisory tools for suitable consumer lending practices* (July 2014); International Monetary Fund, *Dealing with Household Debt*, (World Economic Outlook 2012).

⁴ See e.g. European Commission, *Discussion Paper for the Amendment of Directive 87/102/EEC concerning consumer credit* (2001); see also the Recitals of the Consumer Credit Directive, *infra* note 17 and the Mortgage Credit Directive, *infra* note 18.

⁵ European Commission, *Communication for the Spring European Council, Driving European Recovery*, COM(2009) 114 final, 4 and 7.

⁶*Ibid.*, 7.

the internal market. Over-indebtedness becomes incorporated in the rhetoric of ‘responsible lending and borrowing’ as an introduction of best market practices to be achieved by means of the regulatory public intervention on the behaviour of the contracting parties of credit agreements.

Responsible lending makes reference to the delivery of responsible and reliable markets, where consumer confidence is restored and credit products are appropriate for consumers’ needs and tailored to their ability to repay their debts. It envisages a framework that should ensure that all lenders and intermediaries act in a fair, honest and professional manner before, during, and after the lending transaction. Similarly, for responsible borrowing it is expected that in order to obtain credit consumers provide relevant, complete and accurate information on their finances. They are also encouraged to make informed and sustainable borrowing decisions.⁷

The policy documents specifically target measures to adequately assess, by all appropriate means, borrowers’ creditworthiness before granting them a loan, thus attempting to tackle over-indebtedness. The focus is on the advertising and marketing of credit products, the information to be provided to borrowers prior to granting any loans, ways to assess product suitability and borrower creditworthiness, advice standards, responsible borrowing and issues relating to the framework for credit intermediaries (for example, disclosures, registration, licensing and supervision).⁸

Conceptually, it may not be straightforward why imposing such a duty on party autonomy for what already appears to be in their self-interest: *prima facie*, lenders have no self-interests in giving credit irresponsibly, i.e. lending money that will be unlikely repaid to them. Moreover, the economic literature has long explained that the credit industry is traditionally risk-averse.⁹ Likewise, with the exclusion of the disproportional fewer cases of fraud, it may be unclear why someone would borrow money knowing that s/he cannot repay them back with all the harsh consequences that follow from non-payment.

⁷ See Communication of the European Commission to the European Council of 4 March 2009 ‘Driving European Recovery’, COM (2009) 114 and the Public Consultation on Responsible Lending and Borrowing, available at atec.europa.eu/internal.../responsible_lending/consultation_en.pdf.

⁸ Ibid.

⁹ E.g. see Stiglitz and Weiss, “Credit Rationing in Markets with Imperfect Information”, 71(3) *American Economic Review* (1981), 393-410; Akerlof, “The market for ‘Lemons’: Quality uncertainty and the market mechanism”, 28(3) *Quarterly Journal of Economics*, (1970), 523-547; Diamond, “Monitoring and Reputation: The Choice between Bank Loans and Directly Placed Debt”, 99(4) *Journal of Political Economy* (1991), 689-721; Admati and Pfleiderer, “Forcing Firms to Talk: Financial Disclosure Regulation and Externalities”, 13 *Review of Financial Studies* (2000), 479-519.

Yet, financial markets have demonstrated distortions in such basic principles. Recent experience has shown how lenders have devised instruments to pass on the risk of default to third parties, ultimately creating dangerous financial products, discouraging the former to act responsibly towards their original interest.¹⁰ Also, in a very competitive market the costs of properly assessing the risks of defaults through individualised controls - coupled with the pressure to gain market share and acquire new customers approving quickly credit applications - may encourage financial institutions to budget the losses of defaults in the cost of credit. Likewise, false economic assumptions of the ever rising value of collaterals such as property may induce lenders to exceed limits. Again, sale structures via intermediaries who earn their fees through commissions incentivise the latter to conclude as many credit agreements as they can.¹¹

These behaviours are driven by competition and in a way they open a further debate as to what extent competition and consumer protection in the financial marketplace are compatible. This exceeds the purpose of this Chapter but it shows how competition, alongside ‘predatory’ yet not ‘fraudulent’ business models taking advantage of indebted consumers,¹² may provide market failures of ‘irresponsible’ behaviour which need correction.

By the same token, behavioural economics has demonstrated that borrowers are not rational maximisers of their resources and they may well take wrong borrowing decisions or have decisional biases even if they are provided with adequate information.¹³

The above are market failures that may justify the intervention of public measures of responsible credit. The restoration of a contractual balance between the parties of a credit agreement, redistributive justice, and paternalism may be additional rationales. Others have identified a further justification in a public broader function of regulation to prevent citizens from falling below a minimum welfare level within a healthy free market economy, thus protecting social welfare.¹⁴

¹⁰ See e.g. Engel and McCoy, *The Subprime Virus* (OUP, 2011).

¹¹ Europe Economics, *Study on Credit Intermediaries in the Internal Market*, MARKT/2007/14/H (Brussels, 15 January 2009), at http://ec.europa.eu/finance/finservices-retail/docs/credit/credit_intermediaries_report_en.pdf.

¹² See e.g. the sweatbox business model of credit cards or payday lending. Mann, “Bankruptcy Reform and the ‘Sweatbox’ of Credit Card Debt”, 1 *University of Illinois Law Review* (2007), 375-403.; Pottow, “Private Liability for Reckless Consumer Lending”, 1 *University of Illinois Law Review* (2007), 405-465; McAteer and Beddows, *Fixing a broken market* (Report for Association of Chartered Certified Accountants, 2014).

¹³ Sustain, “Boundedly Rational Borrowing”, 73 *University of Chicago Law Review* (2006), 249-270; Ramsay, “From Truth in Lending to Responsible Lending”, in Howells, Janssen and Schulze (Eds.), *Information Rights and Obligations* (Ashgate 2005), 47-65; Howells, “The Potential and Limits of Consumer Empowerment by Information”, 32 *Journal of Law and Society* (2005), 349-370.

¹⁴ Atamer, “Duty of Responsible Lending: Should the European Union Take Action?”, in Grundmann and Atamer (Eds.), *Financial Services, Financial Crisis and General European Contract Law* (Kluwer 2011), 179-

But the question remains as to how ‘responsible lending and borrowing’ are translated into law and tackle over-indebtedness. Similarly, once introduced as legal measures, it remains to be ascertained to what extent on their own they are sufficient to stem the problem.

2. The establishment of responsible lending in EU law

The responsible lending principle as it currently stands in EU law consists mainly of the legislative requirement for the creditor to assess the creditworthiness of the consumer and to confirm that the latter will be able to repay his credit.¹⁵ However, laying down the exact content of this principle is quite complex, even more so at European level, for two reasons: the first is that it is directly linked with the market characteristics and specific conditions prevailing in each Member State, which may differ substantively; the second reason is that it is very difficult to achieve consensus at a political level regarding the extent of regulatory intervention.

Although the study of over-indebtedness and the examination of possible initiatives at European level to tackle the phenomenon had started quite early,¹⁶ the establishment of the legislative requirement to assess the consumer’s creditworthiness, which is a fundamental element of the responsible lending principle, took place only recently. In particular, it was adopted for the first time with Directive 2008/48/EC on credit agreements for consumers¹⁷ and later with Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property.¹⁸

2.1 The emphasis on the responsible creditor

The principle of responsible lending is not limited to the creditworthiness assessment requirement. It also includes – indirectly in the Consumer Credit Directive and directly in the

202; Posner, “Contract Law in the Welfare State: a Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract”, 24 *Journal of Legal Studies* (1995), 283-319.

¹⁵ The obligation to confirm the capability of the consumer to repay his credit is expressly provided for only in Directive 2014/17/EU and not in Directive 2008/48/EC on consumer credit.

¹⁶ See in detail Λιβαδά, *Το νέο ευρωπαϊκό ρυθμιστικό πλαίσιο για την καταναλωτική πίστη* (Νομική Βιβλιοθήκη 2008), 319.

¹⁷ Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC, OJ L 133/66. In consistency with note 72

¹⁸ Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010, OJ L 60/34. In consistency with note 72

Mortgage Credit Directive – an approach of strong intervention with regard to the conclusion of the credit agreement, focusing on the responsible creditor.

In particular, the approach of the *Crowther Report* of 1971, on which the British legislation for consumer credit was based seems to have been abandoned at European level. According to this Report: “the first principle of social policy should be to treat the users of consumer credit as adults who are fully capable of managing their own financial affairs and not to restrict their freedom of access to it in order to protect the relatively small minority who get into difficulties”.¹⁹ Instead, the assumption made at present has the vulnerable consumer as a point of reference, who - even when he receives sufficient information - is not able either to manage efficiently the risks he takes or to calculate appropriately his economic capabilities. Thus, he is in need of increased protection.²⁰

At the same time, it is accepted that the credit risk to which the creditor is exposed may – under normal circumstances - be manageable and controllable, owing to sufficient diversification of his portfolio or to his ability to ensure his profitability in alternative ways. Moreover, a creditor's aggressive commercial policy or the conditions of competition prevailing in the market may result to a lack of sufficient incentive not to grant credit to persons with a high risk of over-indebtedness.²¹ The crucial question arising in this case is if the creditor, even when he himself is not at risk, should not grant credit to a consumer because of the risk of over-indebtedness for the latter and, in any case, if the creditor is obliged to take certain preventive measures in this respect, and, if so, to what extent. On the other hand, risk-management processes have proven to be inadequate in certain cases. For example, in mortgage credit this inadequacy may be attributed to certain credit institutions' tendency to rely on the value of the residential immovable property, to the possibilities of credit default transfer through securitisation or factoring, as well as to conflicts of interest created, especially in the past, from compensation policies encouraging the granting of credit irrespective from the bad debts created.²²

¹⁹Fairweather, “The development of responsible lending in the UK consumer credit regime”, in Devenney and Kenny (eds.) *Consumer Credit, Debt and Investment in Europe* (CUP 2012), 84-110, at 86.

²⁰Garcia Porras and Van Boom, “Information disclosure in the EU Consumer Credit Directive: opportunities and limitations”, in Devenney and Kenny (eds.), *supra* note 19, 21-55; Fairweather, *supra* note 19, at 89-90, Nield, “Mortgage finance: who’s responsible?” in Devenney and Kenny (eds.), *supra* note 19, 160-181, at 168-169.

²¹*Ibid.*

²² See Commission Staff Working Paper, *Impact Assessment, Accompanying document to the Proposal for a Directive of the European Parliament and of the Council on credit agreements relating to residential property* (SEC 2011, 356) Vol. I, p. 15 and Vol. II, p. 203. See also Financial Services Authority, *Mortgage Market Review: Responsible Lending*, (2010), 10/16, Annex 1, Part 1, at 1, 5-11. It is worth noting that remuneration policies were among the first fields in which “corrective” measures were taken immediately after the outbreak of the crisis, both at international and European level. See as a mere indication Financial

In this framework, the European Commission considers that linking the creditworthiness assessment with the granting of credit, and establishing the requirement for the creditor to grant credit only if the result of creditworthiness indicates that the obligations resulting from the credit agreement are likely to be met, shall contribute to the promotion of financial stability. Thus it will be ensured that creditors shall act responsibly and make sound decisions concerning the granting of mortgage credit.²³

As a result, according to the European legislation, the framework of responsible lending is creditor-centred, as it is the creditor who must assess the creditworthiness of the consumer and make use of its results in the best way possible with regard to the granting of credit or not.

2.2 The content of the obligation to assess the creditworthiness of the consumer

The assessment of creditworthiness is to take place both before the conclusion of the credit agreement and before any significant increase in the total amount of credit after the conclusion of the credit agreement.²⁴

The main pillars of the obligation of assessment are, in both cases, pursuant to Directive 2008/48/EC and Directive 2014/17/EU:²⁵

- sufficient information obtained from the consumer either by the creditor or by the credit intermediary, if the latter intervenes for the conclusion of the credit agreement, and
- consultation of the relevant database.²⁶

However, the provisions of the two legal acts concerning the obligation of responsible lending differ substantively; the relevant provisions of Directive 2008/48/EC are quite laconic and consequently general,²⁷ while those of Directive 2014/17/EU are clearly much more detailed.

Stability Board, *Principles for Sound Compensation Practices*, (April 2009) at <http://www.financialstabilityboard.org/publications/r0904b.pdf> and Financial Stability Board, *Principles for Sound Compensation Practices. Implementation Standards*, (September 2009), at http://www.financialstabilityboard.org/publications/r_090925.pdf.

²³ See Commission Staff Working Paper(2011), *supra* note 22, Vol. I, 21 and Vol. II, 220.

²⁴ See Directive 2008/48/EC, Article 8 and Directive 2014/17/EU, Article 18 para. 1, 6, respectively. For the difference between the assessment of creditworthiness and of affordability, see in detail Fairweather, *supra* note 19, 93-99.

²⁵ See Λιβαδά, «Η εξέλιξη της αρχής «του υπεύθυνου δανεισμού» στο ενωσιακό δίκαιο με έμφαση στις ρυθμίσεις της υπό υιοθέτηση πρότασης Οδηγίας για τις συμβάσεις πίστωσης σε ακίνητα κατοικίας», 2 *Χρηματοπιστωτικό Δίκαιο* (2012), 205.

²⁶ See Καραγιάννης, «Προσέγγιση μιας περίπτωσης ανεπίτρεπτης σύνδεσης δεδομένων προσωπικού χαρακτήρα με την αξιολόγηση της πιστοληπτικής ικανότητας», 3 *Χρηματοπιστωτικό Δίκαιο* (2010), 311.

²⁷ See Fairweather (2012), *supra* note 19, 94.

In particular, article 8 of Directive 2008/48/EC provides for the obligation of the creditor to assess the consumer's creditworthiness before the conclusion of the credit agreement "on the basis of sufficient information, where appropriate obtained from the consumer and, where necessary, on the basis of a consultation of the relevant database".²⁸ However, in this provision neither the content of the information to be obtained from the consumer in order for the creditor to be able to assess his creditworthiness nor any restrictions of the creditor for the granting of credit in case of negative assessment are determined; on the contrary, in the respective provisions of Directive 2014/17/EU the above issues are specifically addressed.²⁹ Pursuant to article 18 of the Directive 2014/17/EU the creditor shall make a thorough assessment of the consumer's creditworthiness taking appropriate account of factors relevant to verifying the prospect of the consumer to meet his obligations under the credit agreement.³⁰ According to the guidance given in the Directive to the creditor, Member States shall ensure that:

- (i) the procedures and information on which the assessment is based are established, documented and maintained and
- (ii) the assessment of creditworthiness shall not rely predominantly on the value of the residential immovable property exceeding the amount of the credit or the assumption that the residential immovable property will increase in value unless the purpose of the credit agreement is to construct or renovate the residential immovable property.³¹ The purpose of this provision is to ensure

²⁸ Directive 2008/48/EC, art.e 8 para. 1.

²⁹ In particular, the question arising thereof is whether in case of negative creditworthiness assessment, the creditor should or could grant the credit or not. Both approaches have been supported by scholars. See, indicatively, Λιβαδά (2008), *supra* note 16, 325 and Μεντή, *Αμυνα & ελευθέρωση του υπερχρεωμένου οφειλέτη* (Δίκαιο και Οικονομία 2012), 33 in favour of the view according to which the creditor should not grant the credit in such a case, as well as Περάκη, «Η αρχή του «υπεύθυνου δανεισμού» και η πρόσφατη κοινοτική Οδηγία για την καταναλωτική πίστη», 3 *Χρηματοπιστωτικό Δίκαιο* (2009), 357-358, Τασίκα, «Η υποχρέωση του πιστωτικού φορέα για αξιολόγηση της πιστοληπτικής ικανότητας του καταναλωτή στην παροχή καταναλωτικής πίστης», *Νομικό Βήμα* (2011), 2293, 2299, Πελλένη-Παπαγεωργίου, *Ζητήματα από τις νέες ρυθμίσεις για τις συμβάσεις καταναλωτικής πίστης* (Εκδόσεις Αντ. Ν. Σάκκουλα 2012), 221-223 in favour of the view according to which the creditor remains free to provide the credit; he could warn the consumer on his low creditworthiness, but this does not mean that he should abstain from the granting of credit.

³⁰ Directive 2014/17/EU, Article 18 para. 1 and recital 55 according to which: "In particular, the consumer's ability to service and fully repay the credit should include consideration of future payments or payment increases needed due to negative amortisation or deferred payments of principal or interest and should be considered in the light of other regular expenditure, debts and other financial commitments as well as income, savings and assets. Reasonable allowance should be made for future events during the term of the proposed credit agreement such as a reduction in income where the credit term lasts into retirement or, where applicable, an increase in the borrowing rate or negative change in the exchange rate". For the initial drafting of the relevant provisions of the proposal for a directive, see Λιβαδά, *supra* note 25, 207, FinCoNet, *supra* note 3, 60-71.

³¹ Directive 2014/17/EU, article 18 para. 2-3.

that the creditor does not rely solely on the value of the immovable property given as collateral for the credit, if the consumer does not possess any other means sufficient for the repayment of his loan.³²

Furthermore, according to para. 5 of article 18 the creditor only makes the credit available to the consumer where the result of the creditworthiness assessment indicates that the obligations resulting from the credit agreement are likely to be met in the manner required under that agreement.³³ Therefore, if the assessment is negative, in the sense that the outcome is that the consumer is not likely to be able to repay his loan, the creditor should not – pursuant to this provision - grant the credit.³⁴ Moreover, should the case arise, the creditor must also be able to invoke the specific indications he took into account for the assessment of the said consumer's ability to repay the loan.³⁵

Clearly the will of the European legislator is to impose a duty to deny credit in such a case and to intervene in the freedom of the contractual parties, who could have wished to proceed to the conclusion of the credit agreement despite the negative assessment.³⁶

The establishment of such an obligation does not mean, on a reversed reading, that a positive creditworthiness assessment obliges the creditor to provide the credit. This is expressly provided for in the relevant recital of the Directive.³⁷ The same conclusion would be drawn even without any relevant reference as the imposition of such an obligation which would also constitute an intervention in the general principle of the freedom of contracts, presupposes an express legislative provision justified by reasons of superior public interest.³⁸ Thus, it is the creditor who makes the final decision to grant credit considering, among others, his business policy, his prospects, the market and economy conditions and his overall strategy.

2.3 The guidelines of the European Banking Authority

³²Directive 2014/17/EU, recital 55. See also Fairweather, *supra* note 19, 91-92, Nield, *supra* note 20, 173.

³³ See also Directive 2014/17/EU, recital 57.

³⁴ An obligation to deny credit exists already under the Swiss law for consumer credit since 2003 (*Loi sur le crédit à la consommation*), even if not directly, but by combining the relevant provisions (articles 28-32). Moreover, heavy sanctions are imposed in case of substantive infringement of the said obligation (see Stauder, Favre-Bule, *Droit de la consommation. Loi sur les voyages à forfait, Code des obligations, articles 40a-40f CO. Loi sur le crédit à la consommation. Commentaire* (Helbing Lichtenhahn 2004), 188).

³⁵ See also Περάκη, *supra* note 29, 356-357.

³⁶ See Περάκη, *supra* note 29, 357.

³⁷Directive 2014/17/EU, recital 57.

³⁸ For the prevailing opinion in theory that the start of negotiations does not in any way create an obligation to conclude the agreement see, Γεωργιάδη, *Γενικές Αρχές* (Εκδόσεις Αντ. Ν. Σάκκουλα 1997), 378, Ρόκα, Γκόρτσου, *Στοιχεία Τραπεζικού Δικαίου. Δημόσιο § Ιδιωτικό Τραπεζικό Δίκαιο* (Νομική Βιβλιοθήκη 2012), 227, 233-234.

In order to ensure that the abovementioned provisions of Directive 2014/17/EU on responsible lending are implemented and supervised consistently across the EU Member States, the European Banking Authority (EBA) has issued guidelines on the way in which the creditworthiness assessment should be conducted. These guidelines enter into effect in March 2016, with the exception of the information requirements which apply from the first day following the date of publication in the official languages of the Member States.³⁹

By way of indication, according to EBA's guidelines, the creditor - when verifying a consumer's prospect to meet his obligations under the credit agreement as referred to in Article 18 of Directive 2014/17/EU - "should make reasonable enquiries and take reasonable steps to verify the consumer's underlying income capacity, the consumer's income history and any variability over time. In the case of consumers that are self-employed or have seasonal or other irregular income, the creditor should make reasonable enquiries and take reasonable steps to verify information that is related to the consumer's ability to meet his/her obligations under the credit agreement, including profit capacity and third-party verification documenting such income".⁴⁰

However, there is no guidance, for example, as to whether the income includes only the net individual income and/or the family income, what is the period of time for which data should be gathered – particularly in the case of consumers with variable income depending on various parameters such as the profitability of the enterprise where they are employed or the market conditions - and what applies for the calculation of the income in case of consumers who will retire within the duration of the credit agreement and thus their income will be reduced.⁴¹

The precise determination of several of those elements which should be checked by the creditor is objectively quite difficult, since their configuration depends on many different factors varying per category of borrower and the market of each Member State.⁴² Moreover, taking into account the long average duration of home loans,⁴³ the assessment process is quite

³⁹European Banking Authority, *Final Report. Guidelines on creditworthiness assessment* (EBA/GL/2015/11). The guidelines of EBA are governed, under article 16 of its founding Regulation 1093/2010 by the principle "comply or explain" for its member supervisory authorities.

⁴⁰*Ibid.* under 1.1-1.2, p. 10.

⁴¹ E.g. see the guidelines of the UK Commission for Competition and Consumer Protection, Office of Fair Trading, *OFT* (March 2010, updated February 2011): *Irresponsible lending – OFT guidance for creditors*, 40-45. See also Finlay, *Consumer Credit Fundamentals* (Palgrave Macmillan 2009), 143-144.

⁴² See also FinCoNet, *supra* note 3, 15: "the decision-making process for how and when a consumer can, or should, enter into a credit contract can be very complex. A range of factors can influence the decision and it can have extensive ramifications for the consumer, the credit provider and, indirectly, the economy as a whole".

⁴³ See Finlay, *supra* note 41, 14-15.

complex and cannot but end up to assumptions and indications. This is exactly why in Article 18 para. 5 of the Directive reference is made to the terms “likely to be met”, as it is impossible to have certainty, even more so in periods of financial instability or crisis.

2.4 Measures aiming at the creation of the responsible borrower

As already mentioned, according to the European legislation in force, responsible lending focuses on the obligations of the creditor who carries the main responsibility to assess the creditworthiness and ensure that the borrower will be in a position to repay the credit provided to him. In this framework, Directive 2008/48/EC does not establish any obligation for the borrower, while Directive 2014/17/EU is limited to urging the consumer to provide the creditor with the information needed for the assessment of his creditworthiness. However, the concept of responsible lending cannot but include the responsible borrower as well.⁴⁴ More particularly, in the provisions of Directive 2008/48/EC, in which the obligation of creditworthiness assessment was adopted for the first time at European level, there is no reference to the borrower’s obligations except from recital 26, where it is mentioned that: “Consumers should also act with prudence and respect their contractual obligations”. Therefore no obligation is established; there is only a light suggestion that the borrower should also be prudent on his part, i.e. regarding the planning of his family budget, avoiding to undertake credit that he cannot afford and being diligent concerning his obligations. The suggestion to respect his contractual obligations does not concern responsible lending but an obligation he has under the general provisions.

In Directive 2014/17/EU, the European legislator focuses on the need of the consumer's participation in the process of his creditworthiness assessment, in the sense that he should provide the creditor with the information required for this purpose. According to Article 20 para. 3 of the Directive, the creditor should specify in a clear and straightforward way, at the pre-contractual stage, the necessary information and independently verifiable evidence that the consumer needs to provide, and the timeframe within which the consumer needs to provide it.⁴⁵ In this framework, the consumer should be aware that he needs to provide

⁴⁴ See Ryder, Griffiths, and Singh, *Commercial Law. Principles and Policy*(CUP 2012), 509, FinCoNet, *supra* note 3,15.

⁴⁵ On the basis of the principle of good faith, it should be accepted that both parties may, at a reasonable time period, complete and/or update this information, if it was not possible for objective reasons to produce a certain document or if important changes concerning the consumer took place during this period which have an impact on the assessment of his creditworthiness.

information which is correct and as complete as possible.⁴⁶ Furthermore, the creditor and, where applicable, the credit intermediary or the appointed representative shall warn the consumer that, where the creditor is unable to carry out an assessment of creditworthiness because the consumer chooses not to provide the information or verification necessary for this assessment, credit cannot be granted.⁴⁷

In case it is proven that the consumer knowingly withheld or falsified information he provided to the creditor, the latter is allowed to denounce the credit agreement.⁴⁸

Thus, the creditor is responsible to determine the data and information needed from the consumer in order to assess his creditworthiness – without prejudice to Directive 95/46/EC - and the consumer is responsible to provide the creditor with correct, complete and precise information.⁴⁹

Considering that the creditworthiness assessment of the consumer is carried out on the basis of information provided by the consumer and, where applicable, internal or external sources of the creditor including databases, with regard to the first part of information the creditor depends to a great extent on the soundness of information provided by the consumer.

In parallel, the consumer, in order to receive the credit he wants, often tends to be over-optimistic as to the affordability of the credit or he is not able to understand the risks inherent to the conclusion of the credit agreement;⁵⁰ as a result he does not provide – intentionally or by negligence - the creditor with the correct information for the assessment of his creditworthiness.

⁴⁶ Directive 2014/17/EU, Article 20 para. 4. Furthermore, according to Article 18 para. 1, the creditor should himself judge the need to verify the information provided from the consumer and to ask him to produce the relevant documentation, where applicable. Even if it is not expressly provided for, the creditor should not take into account elements for which he knows or he should know, from other sources of information to which he has access either in the framework of a contractual relationship he already has with the consumer or from databases, that they are manifestly unfounded and false.

⁴⁷ Directive 2014/17/EU, Article 20 para. 4. According to the same provision, this warning may be provided in a standardised format.

⁴⁸ Directive 2014/17/EU, Article 20 para. 4. See also Article 18 para. 4, according to which: “Member States shall ensure that where a creditor concludes a credit agreement with a consumer the creditor shall not subsequently cancel or alter the credit agreement to the detriment of the consumer on the grounds that the assessment of creditworthiness was incorrectly conducted. This paragraph shall not apply where it is demonstrated that the consumer knowingly withheld or falsified the information within the meaning of Article 20” as well as recital 58 of the Directive: “While it would not be appropriate to apply sanctions to consumers for not being in a position to provide certain information or assessments or for deciding to discontinue the application process for getting a credit, Member States should be able to provide for sanctions where consumers knowingly provide incomplete or incorrect information in order to obtain a positive creditworthiness assessment, in particular where the complete and correct information would have resulted in a negative creditworthiness assessment and the consumer is subsequently unable to fulfil the conditions of the agreement”.

⁴⁹ Directive 2014/17/EU, Articles 18 para. 7 and 20 para. 5.

⁵⁰ E.g. see Financial Services Authority, *supra* note 22, 57-58.

Therefore, the obligation of the consumer to provide correct and complete information in the process of his application for credit, the warning – as mentioned above - to the consumer concerning the consequences in case he does not collaborate with the creditor, and the right of the creditor to denounce the credit agreement, if the consumer knowingly provided falsified or incorrect information contribute, without doubt, to the encouragement of his active participation in the process of his creditworthiness assessment and the demonstration of responsible behaviour on his part in this stage of the process.

In other words, it is expected that the establishment of these obligations for the consumer shall contribute to him exhibiting diligence as a “responsible borrower” when he concludes a credit agreement and avoiding to undertake obligations, which he knows or should know that he is not able to meet. At the same time, in this way the important role of both parties in the implementation of the responsible lending principle is highlighted, in the sense that this principle undoubtedly presupposes the contribution of both contractual parties.⁵¹

Consequently Directive 2014/17/EU is considered quite positive although in need of further enhancement to achieve a responsible behaviour by the consumer during the lending process.

2.5 Indirect measures

Directives 2008/48/EC and 2014/17/EU establish measures to ensure that the preconditions are in place which will allow the borrower to be able – but not obliged – to show the responsibility required. In this respect, the following obligations of the creditor are mainly established:

- the provision of the appropriate information to the consumer, which will potentially⁵² allow him to understand the credit product and make a conscious decision for the undertaking of the credit, being aware of the obligations he undertakes and the potential risks of the credit for him;⁵³ and

⁵¹ *Ibid.*, 57: “Clearly, firms must give suitable advice and lenders must lend responsibly. But consumers also have an important role to play in the mortgage process – for irresponsible lending goes hand-in-hand with poorly informed or irresponsible borrowing”. See also Office of Fair Trading, *supra* note 41, 13.

⁵² The use by the consumer of the information provided to him either regarding the effort to understand it or use it for a comparative assessment of the products offered is a different issue. See Λιβαδά, *supra* note 16, 19-22; Garcia Porres and Van Boom, *supra* note 20, 47.

⁵³ The provisions on information to be given to the consumer at all the stages of the credit agreement and during the credit agreement constitute the core provisions of both Directives (see Directive 2008/48/EC, mainly Articles 5-6, 10-12 and Directive 2014/17/EU, mainly Articles 8, 13-15, 23, 27). See also in detail See Λιβαδά, *supra* note 16, 165; Garcia Porres and Van Boom, *supra* note 20, 26 ss., FinCoNet, *supra* note 3, 45-51.

- the provision of adequate explanations to the consumer so that he is in a position to assess whether the proposed credit agreement and any ancillary services are adapted to his needs and to his financial situation.⁵⁴

Especially with respect to Directive 2014/17/EU, the establishment of the Member States' obligation to promote measures supporting the financial education of consumers, is expected to play a significant part to this end⁵⁵ as well as the obligation of the creditor, in case he provides or may provide advisory services at a pre-contractual stage, to recommend suitable credit agreements to the consumer on the basis of his personal and financial situation, his preferences and objectives.⁵⁶

Financial education, for the promotion of which an express provision is established in Directive 2014/17/EU, is of decisive importance with respect to the possibility of the consumer to make informed decisions to the extent that, through financial education, the consumer becomes familiar with financial products and acquires the knowledge required for him to be able to manage his debt efficiently.⁵⁷ At this point it should also be mentioned that providing information to a consumer who does not possess the knowledge to comprehend this information is not adequate for the consumer to make conscious decisions; this is the reason why – especially in the last years – increasing emphasis is attributed to the promotion and encouragement of financial education.

On the other hand, the obligation to propose suitable credit agreements to the consumer, under the condition of the provision of advisory services, is different from the obligation of creditworthiness assessment, since it aims to the identification of appropriate credit products for the consumer, independently of his ability to repay them. In other words, it may happen that a consumer may receive positive assessment with regard to his income for more than one

⁵⁴ Directive 2008/48/EC, Article 5 para. 6 and Directive 2014/17/EU, Article 16. It is rightly mentioned that the correct and efficient fulfilment of the creditor's obligation for the provision of adequate explanations contributes to responsible lending to the extent that the consumer is able to better understand the obligations he undertakes and whether he is able to fulfil them (see Office of Fair Trading, *supra* note 41, 31-34), Περάκη, *supra* note 29, 355, 'Τασίκα, «Υποχρέωση των τραπεζών για συνδρομή και παροχή επαρκών εξηγήσεων στον αντισυμβαλλόμενο στην καταναλωτική πίστη» 10 Δίκαιο Επιχειρήσεων § Εταιριών (2011), 1019-1021.

⁵⁵ Directive 2014/17/EU, Article 6 and recital 29. In Directive 2008/48/EC, there is only one reference to financial education in recital 26.

⁵⁶ Directive 2014/17/EU, Article 22. Advisory services may also be provided under the conditions set in Article 22 from the credit intermediary and the appointed representative.

⁵⁷ See Pearson, "Financial Literacy and the Creation of Financial Citizens, in The Future of Consumer Credit Regulation", in Kelly-Louw, Nepf, and Rott(eds.), *The Future of Consumer Credit Regulation*(Ashgate2008), 3-28;Ryder, Griffiths, and Singh, *supra* note 44, 509;FinCoNet, *supra* note 3, 53-57.

credit products; however, one of them may not be suitable for the consumer on the basis of his educational profile or the absence of his familiarity with certain transactions.⁵⁸

Moreover, taking into account the obligation of the creditor to refuse the credit in case of negative creditworthiness assessment and that one of the criteria which should be considered is the financial situation of the consumer, it is clear that products for which the consumer has a negative assessment are not suitable for him.

This obligation is similar to the one established in European capital markets law concerning the conduct of appropriateness or suitability testing depending on the investment service provided each time⁵⁹ however, the appropriateness or suitability test is mandatory before the provision of investment services and free of charge, while the provision of advisory services in the framework of the mortgage credit Directive takes place only upon the consumer's request and is a paid service.

In this sense, it is more similar as to its content with the investment service of investment advice,⁶⁰ i.e. the provision of personalized recommendations to a customer, either upon his request or on the initiative of the investment firm, regarding one or more transactions relating to financial instruments on the basis of his personal and financial situation.

⁵⁸ An illustrative example is that of mortgage loans whereby the consumer pays only interest and, at the end of the agreement's term, he has to repay the principal in full (interest-only mortgages). If the consumer is not familiar with this type of loan and is not in a position to understand the risks it entails, this product is not appropriate for him despite of the fact that his creditworthiness assessment may be positive. For the individual types of loans, see Ψυχομάνη, *Τραπεζικό Δίκαιο. Δίκαιο Τραπεζικών Συμβάσεων, Τόμος II* (Εκδόσεις Σάκκουλα 2010), 185 and especially for consumer loans 207; Commission Staff Working Paper, *supra* note 22, 206.

⁵⁹ This is the obligation of the investment firm to conduct a suitability test when providing investment advice or portfolio management pursuant to para. 4 of Article 19 of Directive 2004/39/EC. Through this test the investment firm shall obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, his financial situation and his investment objectives so as to enable the firm to recommend to the client or potential client the investment services and financial instruments that are suitable for him. Respectively, the appropriateness test is provided for in para. 5 of the Directive 2004/39/EC and is conducted by the investment firm when providing investment services other than those referred to in para. 4. The purpose of this test is to ask the client or potential client to provide information regarding his knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the investment firm to assess whether the investment service or product envisaged is appropriate for the client. See in detail Αλεξανδρίδου, «Τα επενδυτικά προϊόντα της Lehman Brothers και η κάλυψη των ζημιών των επενδυτών, 2 *Δίκαιο Επιχειρήσεων & Εταιριών* (2010), 134, Ρόκα, Γκόρτσου, *supra* note 38, 320-322, Moloney, *EC Securities Regulation*, (OUP 2008), 614-617, Αυγερινό, «Η παροχή των επενδυτικών υπηρεσιών στην Οδηγία MiFID» in Καλλιμόπουλος & Γκόρτσος (eds), *Το θεσμικό και κανονιστικό πλαίσιο της ενιαίας Ευρωπαϊκής Κεφαλαιαγοράς* (Νομική Βιβλιοθήκη 2009), 153, Gortsos, "MiFID's Investor Protection Regime: Best Execution of Client Orders and Related Conduct of Business Rules", in Avgouleas (ed.) *The Regulation of Investment Services in Europe under MiFID: Implementation and Practice* (Tottel Publishing 2008), . 101., McMeel, "Investment Firms – Retail Sector", in Blair, Walker and Purves(eds.), *Financial Services Law* (OUP 2009), 637-680.

⁶⁰ See Λιβαδά, *supra* note 16, 262.

Pursuant to Article 22 para. 5 of Directive 2014/17/EU, it is left at the discretion of the Member States to provide for an obligation for the creditor to warn the consumer when, considering his financial situation, a credit agreement may induce a specific risk for him. Therefore, if the consumer has a negative assessment of his creditworthiness, Article 18 par. 5 shall apply and the creditor shall not grant the credit. On the other hand, if the consumer receives a positive assessment – and under the condition that the creditor provides also advisory services and the national legislator has made use of the abovementioned option - the creditor should warn him for the specific risk the credit agreement may induce for him. According to the relevant provisions of capital markets law, if in the opinion of the provider of the investment services⁶¹ the product or service is not suitable for the customer, he should also warn him for this.⁶²

One of the issues arising thereof is the extent of the creditor's liability in this case. The obligation and liability of the credit institution must end with the issuing of the warning, where applicable, to the consumer,⁶³ who will be responsible for any loss he may suffer, if he chooses the offered credit product despite the warning that it was not suitable for him. Respectively, the consumer takes the risk of an unsuitable product offered to him by the credit institution due to his providing insufficient or no information to it.

3. The cure of over-indebtedness

Consumer defaults are the other side of the same coin, but EU law is oblivious of the negative economic and social consequences generated by the same market that it aims at integrating. To the extent that the EU focuses on the prevention of behavioural causes of over-indebtedness, it overlooks the externalities that are the main causes of the problem leaving a vacuum of market functionalism and consumer protection.

Debt solutions and procedures once consumers become insolvent have been left to the competence of national legislation in a multi-level division of functions between the EU and the Member States, despite a clear interest of the EU in the matter evidenced by the many

⁶¹ The investment services of investment advice and portfolio management are excluded.

⁶² Directive 2004/39/EC, art.19 para.5, 2nd subparagraph. He is also obliged to warn him that he cannot proceed to this assessment, if the (potential) customer does not provide the required information or if the information he produces is inadequate (Directive 2004/39/EC, art. 19, para. 5, 4th subparagraph).

⁶³ See Πόκα, Γκόρτσου, *supra* note 38, 321.

commissioned reports.⁶⁴ Until now EU policy measures or legal instruments that directly cover the financial difficulty of consumers have remained scarce. The only handful documents that the EU has produced are a pre-financial crisis Council Recommendation,⁶⁵ two Opinions of the Economic and Social Committee⁶⁶ and a Recital in a Recommendation with invitation to explore the possibility of applying recommendations designed for business insolvency also to consumers. They all point to declarations of intent or principle regarding the need of prevention, alleviation and rehabilitation with measures such as monitoring, financial education counselling, responsible credit practices, balanced debt enforcement measures, and the promotion of debt adjustment procedures. Leaving aside the non-binding nature of these instruments, other scholars have noticed how in reality the EU had no programmes in place relating to consumer over-indebtedness and the matter did not even appear in the Consumer Policy strategy 2007-2013.⁶⁷ Equally, all what the new European Consumer Agenda does is a generic reference that “households’ over-indebtedness is also worrying” anticipating the above analysed European Commission study,⁶⁸ yet problem-debt deserves no mention in the EU multiannual consumer programme for the years 2014-20.⁶⁹ With the increase of over-indebtedness in the aftermath of the 2008 economic crisis, many Member States have moved towards new or renovated national regimes for the protection of consumers in financial distress and the treatment of the insolvency of natural persons, with nearly all Member States now having a law in place.⁷⁰ However, these are individual but uncoordinated legal initiatives in the Member States which expose the complete absence of common, harmonized or appropriately resourced strategies at EU level. Each Member State

⁶⁴ For a reference of the studies see Kilborn, *supra* note 2.

⁶⁵ Recommendation CM/Rec(2007)8 of the Committee of Ministers to member states on legal solutions to debt problems (20 June 2007).

⁶⁶ Opinion of the Economic and Social Committee on ‘Household over-indebtedness’, (2002/c 149/01); Opinion of the Economic and Social Committee on ‘Consumer protection and appropriate treatment of over-indebtedness to prevent social exclusion’ (Exploratory opinion), INT/726 (Brussels, 29 April 2014). There is also a sketchy mention to over-indebtedness in the European Commission’s Green Paper on Mortgage Credit in the EU COM(2005) 327 final which is limited to the observation that “there is a huge social and human dimension attached to housing and credit, including aspects such as over-indebtedness. Any policy in this area must take that dimension into proper consideration”.

⁶⁷ Niemi, “Consumer Insolvency in the European Legal Context”, 35 *Journal of Consumer Policy* (2012), 443-459; EU Consumer Policy Strategy 2007-2013: Empowering consumers, enhancing their welfare, effectively protecting them, COM(2007) 99 final.

⁶⁸ Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions *A European Consumer Agenda - Boosting confidence and growth*, COM(2012) 225 final.

⁶⁹ Regulation (EU) No 254/2014 of the European Parliament and of the Council of 26 February 2014 on a multiannual consumer programme for the years 2014-20 and repealing Decision No 1926/2006/EC, OJ L 84/42

⁷⁰ London Economics, *Study on means to protect consumers in financial difficulty: Personal bankruptcy, datio in solutum of mortgages, and restrictions on debt collection abusive practices*, Final Report. MARKT/2011/023/B2/ST/FC (December 2012).

has developed its own legislation with own features and institutional infrastructure for the implementation of the law, but whose design has been driven by emergency and purely internal social policy considerations.⁷¹

Within such a fragmented legal framework, the EU has pursued the route of mutual recognition to ensure engagement between the Member States.

The legal instruments which have emanated from the EU concern procedural aspects and jurisdictional rules applicable to cross-border insolvencies mostly in the context of the cognate – yet different – area of business insolvency.

3.1 Council Regulation 1346/2000

Council Regulation (EC) 1346/2000,⁷² though designed for business insolvency, applies also to natural persons as consumers, as long as the national proceedings are listed in its Annex A. The listed national proceedings do not include the large number of national insolvency laws, which have been enacted at a later point in time by the Member States. The application of Brussels I(a) Regulation 1215/2012⁷³ to these uncovered legal instruments is questionable. First, it may apply only to some proceedings as long as these qualify to the requirement of decisions being issued by a ‘court or tribunal’, so it does not apply in those jurisdictions where insolvency proceedings are of administrative nature. Secondly, it does not apply to “bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings”,⁷⁴ where the ‘analogous proceedings’ have been interpreted as including personal insolvency ones by analogy.⁷⁵

A drawback of the above combination is that when a payment plan is confirmed by a Court in a Member State it is not recognised or enforceable in another Member State, with debtors remaining liable to foreign creditors, thus frustrating the aims of the proceedings.⁷⁶

⁷¹ Liu and Rosenberg, “Dealing with Private Debt Distress in the Wake of the European Financial Crisis - A Review of the Economics and Legal Toolbox”, *IMF Working Paper WP/13/44* (2013).

⁷² OJ L 160/1.

⁷³ Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast), OJ L 351/1.

⁷⁴ Article 1(2)(b).

⁷⁵ Linna, “Cross-Border Debt Adjustment – Open Questions in European Insolvency Proceedings”, 23 *International Insolvency Review* (2014), 20-39; Israël, *European Cross-Border Insolvency Regulation* (Intersentia 2005).

⁷⁶ The personal insolvency procedures in Annex A are those of Austria, Belgium, the Czech Republic, Cyprus, Germany, Latvia, Malta, The Netherlands, Poland and partly France, Slovenia, and the UK. See *Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the Application of Council Regulation (EC) No 1346/2000 of 29 May 2000 on Insolvency Proceedings*, COM(2012)

In any event, regardless of the (then) scant number of relevant national proceedings for the insolvency of natural persons in the Annex, the Regulation does neither regulate substantive insolvency law nor attempt to enforce a common system at EU level, but it deals with matters of jurisdiction, recognition and enforcement, applicable law and cooperation in cross-border proceedings. The principle of mutual recognition is the central point of the Regulation. The aim is to make sure that insolvency proceedings opened in one Member State are recognized in all other Member States. The Regulation establishes that the domestic law of the country where the case is opened is applicable for the insolvency proceedings and their effects.⁷⁷ In theory, as the determination of who qualifies for bankruptcy/insolvency is determined under national law,⁷⁸ any European consumer who meets the qualification criteria of a country which does permit consumer insolvency has the ability and right to access this, effectively making their domestic or other legislative position irrelevant.⁷⁹ The Regulation further provides that the domestic law of the country where the case is opened is applicable as long as the individual has established a ‘centre of main interest’ (COMI) in the relevant jurisdiction. The concept of COMI, designed with businesses in mind, corresponds to the place where the debtor conducts the administration of his interests on a regular basis.⁸⁰ Incidentally, the Regulation’s rules have given rise to forum shopping by a handful of natural persons through abusive COMI-relocation. But this is an irrelevant issue for over-indebted consumers, as COMI provisions could be capable of affecting a minority of skilled or well-informed individuals/small traders who take advantage of regulatory arbitrage, but they can hardly be applicable to the large majority of millions of people in real financial distress across the EU, i.e. the vulnerable consumers.

3.2 The Recast Regulation 2015/848

The Recast Regulation 2015/848⁸¹ - which comes into effect from 26 June 2017 and only applies to insolvency proceedings opened after that date⁸² - builds on the main shortcomings

743 final. According to London Economics, *supra* note 70, many countries have moved or are moving from judicially-led to administrative processes because of the high costs of the former when consumers are unable to meet such costs.

⁷⁷ Article 4.

⁷⁸ Article 4.2(a).

⁷⁹ London Economics, *supra* note 70.

⁸⁰ Recital 13.

⁸¹ Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on Insolvency Proceedings (Recast), OJ L 141/19.

⁸² Ahead of that date, Member States will be required under Art. 86 to provide a description of their national insolvency legislation and procedures. In turn, Art 24(1) – to come into effect on 26 June 2018 - provides for the

identified under the Regulation 1346/2000, namely its scope of application, the exact determination of which Member State is competent to open insolvency proceedings and issues with COMI jurisdiction (forum shopping, above), the opening of secondary proceedings in other Member States, problems with rules on publicity of proceedings and the lodging of claims, and the absence of specific rules dealing with the insolvency of multinational enterprises.⁸³

The Recast Regulation includes pre-insolvency proceedings for viable debtors and the many personal insolvency proceedings that were outside the scope of the prior law due to their later enactment in the Member States. The Recast goes further than the liquidation proceedings of its predecessor, extending to proceedings which provide for the restructuring of a debtor at a stage where there is only a likelihood of insolvency, proceedings which leave the debtor fully or partially in control of his assets and affairs, and proceedings providing for a debt discharge or a debt adjustment of consumers and self-employed persons. The employed technique is the addition to the pre-existing requirement of proceedings based on laws in which “a debtor is totally or partially divested of its assets and an insolvency practitioner is appointed”⁸⁴ of the alternative of proceedings where “the assets and affairs of a debtor are subject to control or supervision by a court”.⁸⁵ The Recitals reinforce that since consumer proceedings do not necessarily entail the appointment of an insolvency practitioner, they should be covered by the Recast Regulation only if they take place under the control or supervision of a Court (including situations where the Court only intervenes on appeal by a creditor or other interested parties).⁸⁶

The new law also clarifies that it applies only to proceedings which are based on laws relating to insolvency, thus not only excluding proceedings based on general company law not designed exclusively for insolvency situations, but also specific proceedings in which debts of a natural person of very low income and very low asset value are written off, provided that this type of proceedings do not make provisions for payment to creditors.⁸⁷ This excludes the application of proceedings in those Member States where laws have been designed to

establishment of publicly available insolvency registers in each Member State, with the European Commission to establish a system for the interconnection of these registers by 26 June 2019.

⁸³ See European Commission, Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings, COM (2012) 744 final - followed by the endorsement from the European Parliament’s Legal Affairs Committee (JURI) on 17 December 2013 (MEMO/13/1164).

⁸⁴ Article 1(1)(a).

⁸⁵ Article 1(1)(b).

⁸⁶ Recital 10.

⁸⁷ Recital 16.

maximise creditor returns, or to preserve human dignity where access to discharge has been made easier for consumers with no or little assets⁸⁸ and who are the majority of over-indebted consumers.

The other novelties under the Recast Regulation applicable to consumers regard the improvement of the co-ordination of insolvency proceedings within the EU, the equitable treatment of creditors and the minimisation of ‘forum shopping’, i.e. the movement of assets from one country to another so as to take advantage of a more favourable legal position. In particular, for individuals who do not carry on an independent business or professional activity, COMI is to be presumed to be the place of the individual’s ‘habitual residence’, unless this was shifted in the preceding six months, in which case the presumption does not apply.⁸⁹ As explicated in the Recitals, it should be possible to rebut the presumption, for example where the major part of the debtor's assets is located outside the Member State of the debtor's habitual residence, or where it can be established that the principal reason for moving was to file for insolvency proceedings in the new jurisdiction, and where such filing would materially impair the interests of creditors whose dealings with the debtor took place prior to the relocation.⁹⁰ Evidence about the location needs to be put forward, as strengthened under Article 4 which requires the Court of its own motion to examine whether it has jurisdiction and to specify the grounds on which jurisdiction is based. In any event, the requirements of ‘habitual residency’ remain unclear, especially in those circumstances when an individual moves to another Member States and it needs to be determined the continuity or stability of such a move.

4. EU procedural control of unfairness: the role of the CJEU

In the wake of the 2008 economic crisis the case-law of the CJEU has shown a surge in litigation grounded in the dated unfair contract terms legislation (UCTD)⁹¹ applied to procedures relating to credit agreements of consumers in financial difficulty (?).⁹²

⁸⁸E.g. the proceedings in the France, Sweden, Austria, Germany Belgium, Estonia, and Denmark. See Kilborn, *supra* note 1.

⁸⁹Article 3.

⁹⁰Recital 30.

⁹¹ Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts ,OJ L 95/29

⁹²Micklitz and Reich, “The Court and Sleeping Beauty: the Revival of the Unfair Contract Terms Directive (UCTD)”, 51 *Common Market Law Review* (2014), 771-808.

The ‘Spanish mortgage saga’ takes stock of the way in which the UCTD has been used on the control over national procedural law to protect over-indebted consumers. Significantly, Spain did not have legislation in place for debt solutions or the insolvency of individual debtors.

From its jurisprudence in *OcéanoGrupo*,⁹³ *Penzügyi*,⁹⁴ and *Invitel*⁹⁵ the CJEU has developed a doctrine of procedural effectiveness of unfair terms obliging national judges to undertake an investigation to assess the effective protection of consumers.

In *Aziz*⁹⁶ Spanish procedural law was found to breach EU law for failing to provide for the assessment of a court with regard to the unfairness of standard terms in a mortgage contract to offer interim relief. Particular reference was made to the impossibility to suspend mortgage execution proceedings, as a result of which the debtor could have been evicted from his property before a court could give a judgment on the fairness of the lender’s standard mortgage terms. As a result, national law was amended to repair the legal flaws concerning the enforcement of mortgage contracts.⁹⁷

Later, in *Sánchez Morcillo*⁹⁸ it was held that the amended Spanish procedural law still fell short of the standards required under the UCTD for leaving to the discretion of the national court the assessment of the unfairness of the relevant terms. Moreover, the law did not grant consumers the same procedural defences accorded to lenders.

Next, *Unicaja Banco* and *Caixabank*⁹⁹ confirmed the trend of Member States having to ensure that over-indebted consumers are protected and not bound by unfair clauses in credit agreements. The question referred by the Spanish courts asked whether it should declare void and not binding on the consumer unfair clauses regarding default interest rates higher than those set by law, or whether they should rather adjust the clause to the statutory limits. In fact, Article 6 UCTD provides that unfair terms should not be binding on the consumer who remains nevertheless bound upon the other terms of the contract if this is capable of remaining in existence without the excluded unfair term. At the same time, EU law does not authorise national courts to revise the content of the unfair term, as affirmed in precedent case-law¹⁰⁰ where the CJEU held that the contract containing the term “must continue in existence, in principle, without any amendment other than that resulting from the deletion of

⁹³Case C-240/98.

⁹⁴Case C-137/08.

⁹⁵Case C-466/11.

⁹⁶*Aziz v. Catalunyacaixa* (Case C-415/11).

⁹⁷Lei 1/2013 amending Article 695 of the Spanish Code of Civil Procedure.

⁹⁸*Sánchez Morcillo y Abril García v Banco Bilbao Vizcaya Argentaria SA* (Case C-169/14).

⁹⁹*Unicaja Banco, SA v José Hidalgo Rueda and others* and *Caixabank SA v Manuel María Rueda Ledesma and others* (Joined Cases C-482/13, C-484/13, C-485/13 and C-487/13).

¹⁰⁰ See *Banco Español de Crédito* (Case C-618/10) and *AsbeekBrusse and de Man Garabito* (Case C-488/11).

the unfair terms, in so far as, in accordance with the rules of domestic law, such continuity of the contract is legally possible”.¹⁰¹ However, in *Kasler*¹⁰² the contract was found to not remain in existence without the unfair clause and, given the negative consequences this would have had on the consumer, the CJEU held that the national court was allowed to replace the unfair term by a supplementary provision of national law. Against this legal background, the referred issue raised difficult questions because the further existence of the mortgage contract might be endangered in case lenders no longer receive interest payments, which may be considered to be an essential part of the mortgage agreement.¹⁰³ Nevertheless, the CJEU held that national law is compatible with EU law insofar as it does not interfere with the national courts' duty to hold unfair terms to be not binding on the consumer, without revising the terms' content,¹⁰⁴ effectively offering protection to the affected consumers. Again, in *BBVA SA v López et al*¹⁰⁵ the CJEU persisted in the reinforcement of the protection of the over-indebted consumer. With reference to cases in which enforcement proceedings were pending and no unfair terms control had been exerted under the procedural rules in place before the *Aziz* case, the new Spanish law granted consumers a one-month period from its publication to bring an action based on the unfairness of a contractual term. The CJEU found that the transitional provision does not guarantee the effective exercise of the new right.

The ‘Spanish saga’ is not over, with a new opinion of the Advocate General in *Finanmadrid EFC SA*¹⁰⁶ heading in the same direction of protection for the over-indebted consumer. Moreover, new preliminary references have already been filed to challenge the other aspects of the Spanish procedural law on the same grounds of unfairness,¹⁰⁷ as well as the testing of its compatibility with the principle of effective judicial protection affirmed in Article 47 of the Charter of Fundamental Rights of the European Union.¹⁰⁸

¹⁰¹ *Unicaja Banco and Caixabank*, para 28.

¹⁰² Case C-26/13.

¹⁰³ *Unicaja Banco and Caixabank*, Conclusions of the Advocate General Whal (16 October 2014).

¹⁰⁴ *Unicaja Banco and Caixabank*, *supra* note 93

¹⁰⁵ Case C-8/14.

¹⁰⁶ *Finanmadrid EFC SA v Jesús Vicente Albán Zambrano and others*, (Case C-94/14). The AG finds it against EU law national legislation not providing for the judge of the execution the possibility to declare *ex officio* abusive clauses void and not binding for the consumer.

¹⁰⁷ Request for a preliminary ruling from the Audiencia Provincial de Cantabria (Spain) lodged on 7 August 2015 — *Liberbank S.A. v Rafael Piris del Campo*, (Case C-431/15)

¹⁰⁸ Request for a preliminary ruling from the Audiencia Provincial de IllesBalears (Spain) lodged on 16 July 2015 — *Francisca Garzón Ramos and José Javier Ramos Martín v Banco de Caja España de Inversiones, Salamanca y Soria, S.A., Intercotrans, S.L.*, (Case C-380/15)

The above case-law suggests what has been defined as a new constitutional role of the CJEU,¹⁰⁹ where the judiciary takes over from politics and substitutes the legislator in policy and law making: where a Member State and the EU failed to put in place measures to provide for the insolvency of over-indebted consumers, the CJEU has been described as engaging in a form of social engineering which compensates for the deficiencies of the pre-established institutions by law.¹¹⁰

5. Concluding remarks

5.1. Prevention and responsible lending/borrowing

The current European framework of consumer and mortgage credit makes reference to responsible lending mainly in the assessment of the consumer's creditworthiness and the direct link – concerning Directive 2014/17/EU - between the results of such an assessment and the granting or not of credit. In this sense, direct intervention to the contractual freedom of the parties is exercised and the creditor cannot provide credit unless the consumer does not have a positive assessment of his creditworthiness.¹¹¹ On the contrary, there is no obligation for the creditor to provide credit in case of positive assessment of the consumer, if the creditor does not want to do so because, for example, of his business policy.

The interventionist approach of the European legislator reflects a turn regarding the treatment of the consumer, considering that he does not always act rationally and autonomously; instead, he is vulnerable to aggressive or misleading practices, he is often not able to understand the consequences of the decisions he makes, and sometimes he tends to act frivolously. However, even if this assumption is true for a large number of consumers, clearly it is not valid for all of them.

It is correctly mentioned that the point of reference of this kind of provisions are the most vulnerable consumers, to the extent that credit for them entails higher and possibly not

¹⁰⁹ See Micklitz, "Unfair Contract Terms – Public Interest Litigation before European Courts Case C-415/11 Mohamed Aziz" in Terry, Straetmans, and Colaert (eds.) *Landmark Cases of EU Consumer Law - In Honour of Jules Stuyck* (Intersentia 2013), 633–52; Gerstenberg, "Constitutional Reasoning in Private Law: The Role of the CJEU in Adjudicating Unfair Terms in Consumer Contracts", 21(5) *European Law Journal* (2015), 599–621.

¹¹⁰ Micklitz, "Conclusions: Consumer Over-Indebtedness and Consumer Insolvency – from Micro to Macro", in Micklitz and Domurath (eds.), *Consumer Debt and Social Exclusion in Europe* (Ashgate, 2015), 229–235; Kelman, *The Transformation of Law and Regulation in the European Union* (Harvard University Press 2012).

¹¹¹ See Nield, *supra* note 20, 178.

controllable risk. However, it would be appropriate for legislation to provide more flexibility to creditors vis-à-vis consumers not demonstrating those characteristics.¹¹² On the other hand, the adoption of such an approach in European legislation is disadvantaged by the difficulty to determine the criteria to differentiate between the various categories of consumers and, probably, it wouldn't be possible to achieve security of law in this way.

In any case, under the current legal framework, the creditor is responsible to make the final decision for the granting or not of credit, based on the results of the assessment. However, taking into account the difficulties arising in the process of the creditworthiness assessment, it is quite possible that – except from the cases in which the result of the assessment is manifest (positive or negative) - when the results are not so clear or if both positive and negative indications exist, the creditor will tend to be reluctant and finally refuse to grant credit or reject applications which he would have accepted under different conditions. This will happen both for grey areas and for lack of adequate verifiable data.

Besides, the creditor has to rely on assumptions and, in particular on the assumptions as at the moment of the conclusion of the credit agreement, making the allowed or imposed deductions with regard to the typically long-term duration of the credit agreement.

As a result, access to mortgage credit will probably be reduced for the more vulnerable and/or less privileged groups of population (for example due to low or unstable or not easily verifiable income¹¹³); those groups may be in more need of credit but, due to the fact that they will not fulfil the criteria or because they will be considered more risky, they will be deprived access to credit, at least in a legal way.¹¹⁴ Such a probability may lead to financial exclusion,¹¹⁵ i.e. exclusion from access to financial services¹¹⁶ of vulnerable and fragile

¹¹²*Ibid.*, 179.

¹¹³According to the Financial Services Authority: "Mortgage sales could be affected by the income verification proposals via two primary drivers. Customers could be excluded from the market for their inability to prove income or mortgage lenders might decide not to offer a mortgage due to the expense of verifying income. Oxera's survey indicated that almost all of the expected reduction in sales volumes from income verification would be expected to arise from applicants being unable to prove income" Financial Services Authority, *supra* note 22, Annex 1, Part 1, para. 80, 20. See also Λιβαδά, *supra* note 25, 213.

¹¹⁴ See Παράκη, *supra* note 29, 358, Brown, "European regulation of consumer credit: enhancing consumer confidence and protection from a UK perspective?", in Devenney and Kenny (eds.), *supra* note 19, 56-83.

¹¹⁵ See Ryder, Griffiths, and Singh, *supra* note 44, 503.

¹¹⁶ For financial exclusion, see indicatively Wilson, "Responsible Lending or Restricting Lending Practices? Balancing Concerns Regarding Over-Indebtedness with Addressing Financial Exclusion", in Kelly-Louw, Nehf, and Rott, (eds.), *supra* note 57, 91-106, Gómez, "Financial Exclusion in the European Union: Addressing Difficulties in Accessing Finance within the Current Integration Framework", 23 *Journal of Contemporary European Studies*, (2015), 100-117; Ambarkhane, Singh, and Venkataramani, "Developing a Comprehensive Financial Inclusion Index", (August 2014), at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2485774.

groups of population that may become over-indebted exactly because they are excluded from the possibility to receive credit.¹¹⁷

The recent Directive 2014/17/EU does not allow drawing safe conclusions about the way the relevant provisions will be implemented; the same applies with respect to Directive 2008/48/EC, which has been transposed to the Member States, but the practices followed have not been consolidated yet. Thus, it is not possible to know their exact impact on the consumer credit market. The difficulty of quantifying the impact of Directive 2014/17/EU is also mentioned by the European Commission in its impact assessment report in the framework of the proposal for a Directive.¹¹⁸ However, the Commission believes that the percentage of reduction of mortgage credit due to the establishment of those provisions will be low,¹¹⁹ while, on the contrary, the benefits for consumers, society and financial services providers will be more important.¹²⁰

The supervisory authorities will play a crucial part concerning the supervision of compliance with these provisions and the imposition of sanctions in case of infringements of the national provisions. The courts will also play a very significant role since they will be called to decide, in case of litigation, whether the granting of credit was responsible or not. As it stands, the core of the principle of responsible lending at European level is the assessment of creditworthiness of the consumer and the link between the assessment and the granting of credit. The contribution of the borrower is limited only to the provision of correct and comprehensive information to the creditor.

This choice of the European legislator entails certain risks, the most important of which may be the exclusion from credit of groups of population not fulfilling the criteria of lending and their consequent over-indebtedness because of the exclusion. Such a prospect is clearly on the opposite direction from the objectives of the regulatory intervention and, if it occurs, it will have to be addressed. In any case, the mechanisms of activation of the responsible borrower, who has and should have an active role in the lending process, should be enhanced. The current European legal framework, according to the abovementioned, moves towards this direction, even if reluctantly, and it should be further reinforced.

5.2. Cure and personal insolvency law

¹¹⁷ See Ryder, Griffiths, and Singh, *supra* note 44, 504, Brown, *supra* note 114, Wilson, *supra* note 116, 101; Perakis(2009), *op. cit.*, p. 358.

¹¹⁸ See Commission Staff Working Paper, *supra* note 22. See also the very detailed impact assessment of the Financial Services Authority, *supra* note 22, 13-34.

¹¹⁹ Ibid.

¹²⁰ Ibid.

The emphasis given to COMI relocation lies far away from the reality of millions of over-indebted vulnerable consumers.

Like its predecessor, the Recast Regulation does not attempt to harmonise substantive provisions and it does not aim at tackling divergences and inconsistencies between individual proceedings under national law.

Mutual recognition and private international law in the EU are legal tools usually employed when it is difficult for Member States to reach agreement on substantive laws. In this sense, they have been portrayed as a fall-back or ancillary position where harmonisation cannot be achieved.¹²¹ As far as personal insolvency legislation is concerned, it would be difficult to negate such a stance.

However, given the absence of substantive harmonisation, some Member States remain exposed to internal weak systems and coordination may not always be straightforward.

A gap in the law is the treatment of consumers with little or no assets. This is often the case with over-indebted consumers, who are in that situation precisely for not having any other means to pay-off their debts. However, substantive laws of the Member States are very different and many countries which focus on creditors' fair treatment and satisfaction exclude this kind of debtors from insolvency proceedings precisely for the impossibility to make a repayment plan. Likewise, the Recast Regulation is explicit in excluding them from its scope. This exclusion may infringe the free movement of vulnerable consumers who after the economic crisis have shown a tendency to move to other EU countries to escape the lack of jobs and austerity in their home Member State.

In *Radziejewski*¹²² the CJEU has already established that national insolvency procedures for natural persons may be restrictive of the fundamental free movement rights of the EU. The case dealt with the issue of residency as a requirement for access to the national insolvency procedure and its lack of compatibility with Article 45 TFEU on the free movement of persons. The CJEU held that national provisions which preclude or deter someone from leaving his country of origin in order to exercise his right to freedom of movement constitute restrictions on that freedom, even if they apply without regard to the nationality of the workers concerned.

¹²¹ Mills, *The Confluence of Public and Private International Law*, (Cambridge University Press 2009). See also Council of the European Union, The Hague Programme: strengthening freedom, security and justice in the European Union available at http://ec.europa.eu/justice_home/doc_centre/doc/hague_programme_en.pdf, 31.

¹²² *Ulf Kazimierz Radziejewski v Kronofogdemyndigheten i Stockholm* (Case C-461/11).

The CJEU jurisprudence over the procedural control of fairness - though significant in providing a remedy to over-indebted consumers and plastering problematic situations emerging from a legal vacuum – has many limits, especially in the large majority of situations where there are no unfair standard terms to be contested in a condition of over-indebtedness. This is the frequent instance where under the UCTD the assessment of fairness of a term cannot relate to the definition of the main subject matter of the contract or to the adequacy of the price or remuneration.¹²³ Such exclusion, for example, made the UCTD powerless to challenge mortgage agreements in foreign currencies that created so many problems in a number of countries. Moreover, consumer protection through procedural means is not easily attainable as it rests on the capacity and resilience of over-indebted consumers to seek enforcement of rights.

All in all, the legislative choices of the EU legislator are questionable. Much can be debated over the details of the law. Overall, however, it is argued that a more cohesive and holistic approach treating the effects of over-indebtedness would be desirable. No policy or law designed to prevent a problem can on its own solve it. Prevention alone, however designed but without ex-post debt solutions, cannot be conclusive.¹²⁴

¹²³Article 4 of the UCTD.

¹²⁴See also Vandone, *Consumer credit in Europe* (Physica-Verlag 2009).